

October 12, 2009

Sent Via Mail and E-Mail

Mr. Matt Josephs
NMTC Program Manager
Community Development Financial Institutions Fund
U.S. Department of Treasury
601 13th Street, N.W., Suite 200 South
Washington, DC 20005

Dear Matt:

On behalf of the members of the NMTC Working Group, we would like to provide the CDFI Fund our comments on the 2009 NMTC Allocation Application (the "Application"). We appreciate the CDFI Fund's efforts to continually examine the application process to determine if there are ways to improve it. We have provided comments to the specific questions in the request for comments and have also provided some additional comments. Some of our comments have also been provided in a format that can be incorporated into a new release of the NMTC Allocation Application Q & A Document dated January 12, 2009 (the "Application Q&A"). For your convenience, we have summarized our comments below in order of the questions posed:

RESPONSES TO THE CDFI FUND'S SPECIFIC QUESTIONS

- 1. Is the information that is currently collected by the Application necessary and appropriate for the Fund to consider for the purpose of making award decisions? Please consider each question and table in the Application. Are there questions or tables that are redundant and/or unnecessary? Should additional questions or tables be added to ensure collection of more relevant information?**

Question 10

For CDEs that have a National service area, it is unclear why it must identify the 7 states with the largest amount of projected activities. At the time of application submission, a CDE may select the 7 states as a priority due to its current pipeline. However, geographic distribution may change as a result of project due diligence, a CDE's best efforts to close deals in a timely manner to meet QEI and QLICI deadlines, or in response to changing investor underwriting requirements. For these reasons, we believe the CDFI Fund has wisely excluded these priority states from the Allocation Agreement. We are concerned that the publication of these priority states for National CDEs may set up unrealistic expectations in those states or in Congress as to where National CDE allocations will be invested. We recommend that the CDFI Fund provide additional clarification about this data by adding the following disclaimer: "This CDE has a national service area in which it can invest in projects across the country. In its application it listed the seven states with the largest amount of projected activities. While the CDE projects to make large investments in these states, the states listed may not reflect the locations of the CDE's actual investments and the CDE is not required to make investments in these states."

Question 14

In question 14, an applicant is required to indicate a percentage of each type of QLICI in which the applicant intends to engage. The percentages assigned to each type of activity are then translated to the Schedule 1 - 3.2(a) of the allocation agreement. While it may be important to determine the types of activities that a CDE intends to engage in, we believe that including the percentages in the allocation agreement provides the CDE with less flexibility in managing its pipeline. Specifically, the clear distinction between non-real estate and real estate QALICBs may prove onerous to a CDE as new deals emerge and old deals drop out of a pipeline. For example, a CDE put together their application intending to engage in a certain percentage of activities with real estate QALICBs. However, after they received their allocation they have found projects with greater community impact that are non-real estate that weren't in their original pipeline. Due to the requirements listed in the allocation agreement, the distinction between non-real estate and real estate may prove to be prohibitive for the CDE, causing it to forego the investment. We don't believe that is the intention but it has become a reality. We recommend that the percentages indicated in question 14 not be included in Schedule 1 of the allocation agreement. If the CDFI Fund continues to include this information in the allocation agreement, we recommend that the distinction between the percentage of QLICIs the CDE intends to make to real estate and non-real estate QALICBs be removed and replaced with "percentage of investments in, or loans to, QALICBs".

Question 16

We recommend that the question be reorganized to allow the applicant to describe the flexible rates and terms that apply to each product the applicant intends to offer, rather than describing each of the items in 16(a) separately. Many applicants offer more than one type of loan product and it can become difficult to explain the different terms used for each product in the amount of space given. The applicant generally has to restate what the loan product is to make sure the reviewer knows the details about the rates and terms that specific product will have. By allowing the applicant to explain each product and its specific rates and terms, we believe it will provide greater continuity in the responses and will allow the reviewer to more easily understand what the applicant plans to offer. For example, if an applicant intends to offer three different loan products, it would provide three responses, one for each loan product. Within each response, the applicant would be required to describe the flexible or non-traditional product, its rates and terms. We recommend that an applicant be allowed 5,000 characters for each response for each product. If the CDFI Fund chooses to require one response for all products, we recommend that it be the maximum amount of characters allowed.

We also recommend that additional clarification be provided regarding each of the products, rates and terms. For example, the differences between debt with equity features and equity equivalent terms and conditions. These are two items that an applicant can check in question 16 that it intends to offer in its loan products. It doesn't appear that there is enough distinction to make the two items separate and therefore many responses may be redundant when both items are checked.

Question 27

We recommend that question 27 be modified to not require the applicant to indicate a percentage of total QLICIs that will be used to finance activities in one or more of the eighteen geographic areas listed in 27(a) in order to provide more flexibility in the types of projects a CDE can invest. We believe that question 27(b) sufficiently requires a CDE to invest in particularly economically distressed or

otherwise underserved communities by requiring an investment in one of the first three areas or a location characterized by two of the remaining items. We believe that there are many examples of high community impact projects that don't fit into one of the categories listed in 27(a) and based upon the CDE's response to question 27, the CDE may feel precluded from investing in the project in order to be generally consistent with its application. If the CDFI Fund chooses to keep the request of 27(a), we recommend that the wording be changed to the following to make it clearer that the percentage indicated is aspirational and not a requirement:

27. Applicant targeting of QLICI activities: Indicate the percentage of total QLICIs (based on dollar amounts) that are projected to be used to finance activities in one or more of the geographic areas identified below. ____ %

We also recommend that non-metropolitan counties be identified as the fourth geographic area of high distress in question 27(a) of the Application instead of the sixteenth. In addition to moving non-metropolitan counties, we recommend revising question 27(b) so that it includes non-metropolitan counties in the top tier of qualifying areas of higher distress. In addition to the non-metropolitan county changes, we recommend making what was previously the fourth item in question 27(a) into three individual items. We have included our recommended revisions to question 27(a) and (b) below:

27(a)

4. ____ [NON-METROPOLITAN COUNTIES] Counties not designated as a metropolitan statistical area in accordance with OMB Bulletin No. 04-03 (Update of Statistical Area Definitions and Additional Guidance on Their Uses) and based on 2000 Census data.
5. ____ [25% POVERTY] Census tract with poverty rates greater than 25%.
6. ____ [70% MEDIAN FAMILY INCOME] Census tract located within a non-Metropolitan Area, median family income that does not exceed 70% of statewide median family income, or, if located within a Metropolitan Area, median family income that does not exceed 70% of the greater of the statewide median family income or the Metropolitan Area median family income.
7. ____ [1.25 UNEMPLOYMENT RATE] Census tract with unemployment rates at least 1.25 times the national average.

27(b)

Will the *Applicant* commit to providing at least 75% of its *QLICIs* (in terms of aggregate dollar amounts) in areas that are either: (1) characterized by at least one of items 1-4 on the above list for each *QLICI*; or (2) characterized by at least two of items 5-20 on the above list for each *QLICI*?

____ Yes ____ No

Question 49

In general, this question seems repetitive of question 48. For example, in part b of question 49, the applicant is asked to describe its strategy for identifying additional sources of capital if any of its initial providers falls through. This part is nearly identical to the second bullet point of question 48. We recommend that questions 48 and 49 be combined to get information from the applicant regarding its overall strategy for securing investments from either direct investors or investment partnerships. We further recommend that the applicant not be required to describe its progress to date in securing the letters in its responses to questions 48 or 49 since the applicant submits the commitment letters and/or letters of interest or intent that it has received.

Questions 51 and 52

We recommend that the CDFI Fund clarify whether an applicant is required to answer yes to the question "Will the Applicant receive any QEIs from Affiliates?" if the applicant or an affiliate is also the managing member of the investment fund. Many CDEs (directly or through an affiliate) act as the non-member manager or managing member of the investment fund that makes the QEI into the CDE with an ownership percentage that is generally less than one percent. This is usually done as an accommodation to the tax credit investor and/or to simplify the reporting requirements. We believe that an applicant shouldn't check yes in this situation since it is only making a nominal capital contribution to the investment partnership. However, without further clarification, it's likely that CDE's are taking different approaches in answering this question which may confuse a reviewer as to the relationship and role of the applicant or its affiliates.

Tables C1 and C2

We recommend that the CDFI Fund clarify if applicants can use data regarding indirect impact collected by the methodologies described in question 30 (e.g. IMPLAN) or if they should only report direct impacts. It is currently unclear, and if some applicants are including indirect data while others are not, it may be hard for a reviewer to know the difference.

In addition to the needed clarification on whether to report indirect impacts, we recommend that the "# of Clients Served" column be removed from the table and be incorporated into question 29. Since the NMTC program allows such a variety of projects to be financed, it becomes very difficult to project the number or types of clients served. Even in an example of one business being served by NMTC financing, the question of what is a client can be very confusing. For example, if an applicant intends to make a NMTC loan to a charter school, should the applicant report the number of children attending the school each year or is the charter school itself the client. With such ambiguity in what is required and the myriad of clients that can be served, we recommend that an applicant be required to explain in their response to question 29 the number and types of clients expected to be served. Otherwise a reviewer will be unable to determine what the applicant's number of clients served amount is related to and how it should be compared to other applications.

Table E1

We recommend that the CDFI Fund modify Table E1 to allow the applicant to indicate if a single investor's commitment is for both debt and equity. Currently, the table requires the applicant to choose between debt, equity and a grant.

- 2. Are the thresholds contained in Question 17 of the Application appropriate, given current economic conditions? If not, what should the criteria include? Should the Fund provide a range of flexible product commitments based on a discount of interest rates below market as defined by basis point reductions (or other product flexibilities) or continue to present commitment options in percentage terms?**

Question 17 requires the Applicant to commit that 100% of its qualified low-income community investments ("QLICs") will have one of five levels of flexible or non-traditional terms. The current choices available to an Applicant related to debt with below market interest rates are interest rates that are a certain percentage below market. We believe that if an Applicant must commit to interest rates at a specific percentage below market, loan products subsidized with NMTCs may become financially infeasible as interest rates change over time.

To illustrate our concern, please consider this example. A Community Development Entity ("CDE") is able to offer market rate loans at a 30 Day LIBOR rate + 2%. In Year 1, the 30 Day LIBOR is 2%, so market rate loans would be 4%. The CDE uses the NMTC subsidy to offer a loan product that is 200 basis points below market. With the NMTC subsidy of 200 basis points, the CDE is able to make QLICs at 2%, which is 50% below market. This would satisfy a 50% below market requirement. In Year 3, the 30 Day LIBOR rate increases to 6% which causes the market rate to be 8%. The amount of NMTC subsidy will remain constant since it will not be affected by changing interest rates over time. Using the 200 basis points of NMTC subsidy, the CDE will be able to make QLICs at 6%, which is only 25% below market rates. In this scenario, the CDE will be unable to satisfy the 50% below market requirement over time due to the increase in the cost of funds.

We recommend that a specific amount of basis points below market be included as a threshold **in addition to** the options for percentages below market and indicia of flexible or non-traditional rates and terms in subsections (a) – (d) of question 17. We suggest that the amount of basis points below market be for subsection (a) debt with interest rates 300 basis points below market, subsection (b) debt with interest rates 250 basis points below market, subsection (c) debt with interest rates 200 basis points below market, and subsection (d) debt with interest rates 150 basis points below market. We believe that this will allow the Applicant to continue to provide below market loan products without the risk of changing interest rates causing a loan product to be infeasible or causing the allocatee to be in default of its NMTC Allocation Agreement.

- 3. A CDE is entitled to earn five "priority points" for committing to invest substantially all of its QEI proceeds in businesses in which persons unrelated to the CDE hold the majority equity interest (within the meaning of I.R.C. section 267(b) or 707(b)(1)). With respect to the timing of this test, the CDFI Fund has determined that it is to be applied after the initial investment is made, and for the life of the seven-year compliance period (though an exception is permitted if events unforeseen at the time of the initial investment cause the CDE to have to subsequently**

take a controlling interest in the business). Is it appropriate that this test is applied after the investment is made, or should the CDFI consider applying this test before the investment is made? If the test is to be applied before the investment is made, then how should the Fund treat circumstances whereby the receipt of the QEI and the investment in the business is essentially a simultaneous transaction, particularly when the CDE may not have any owners identified prior to the QEI closing?

Question 26(a) requires the Applicant to indicate whether it intends to use substantially all of its QEIs to make QLICIs in one or more businesses in which persons unrelated to the Applicant hold the majority equity interest. In the Application Q&A, the CDFI Fund indicates in the response to Question 38 that for purposes of determining if an entity is related (within the meaning of IRC § 267(b) and § 707(b)(1)), the test is conducted **after** the CDE makes the QLICI.

This prevents a CDE from owning a non-managing interest in excess of 50% of the Qualified Active Low-Income Community Business ("QALICB"). Because most QALICBs that the NMTC program is intended to serve do not have substantial capital that would outweigh an equity investment by a CDE, the CDFI's interpretation of the "related party" test forces most QLICIs to be structured as debt in whole or as a substantial part, thus burdening the QALICBs with debt that may be difficult to support and frustrating the statutory purpose of the NMTC program to provide "patient" capital. Forcing most QLICIs to be made as debt also puts great pressure on the "true debt" issue and exposes the transaction to the unnecessary risk that the QLICI may be recharacterized as a grant for tax purposes, thus causing disallowance of the NMTC.

We do not believe that any of these very significant transactional issues (and their attendant legal and accounting costs, which reduce the net benefit to the QALICB) are required by Section 45D(f)(2)(B) of the Code. The statutory requirement in IRC Section 45D(f)(2)(B) does not specifically address the timing of the related party test. Moreover, it is difficult to perceive the policy served by prohibiting investments in entities that become related to the CDE solely as a result of the investment.

We recommend that the Application Q&A be changed to clarify that an Allocatee that claimed priority points for investing in unrelated business will be in compliance with its allocation agreement if it is considered an unrelated entity **after** the QEI is made but **before** the CDE or Sub-CDE makes its initial QLICI in the QALICB. By testing "relatedness" after the QEI, the test will determine if the CDE or Sub-CDE intends to invest in a QALICB that is related to the CDE prior to the actual investment. This approach would ensure that Investors in the CDE or Sub-CDE could not engage in a program of investing in their own businesses, while encouraging the delivery of "patient capital" consistent with the policies of the NMTC program.

In response to your last question, we note that in any NMTC transaction, the QEI must always be made before the QLICI. Thus, even in a "simultaneous" transaction, there is a series of necessary steps, and the related party test can be applied immediately prior to any step. Moreover, we note that there is no situation where the CDE does not have any owners identified prior to the QEI closing. Prior to the QEI closing, the CDE will be owned by the Allocatee and/or its affiliates, because the CDE must be a partnership or a corporation for tax purposes and therefore must have owners. When an investor makes a QEI, it typically replaces 99% of the ownership interest in the CDE. Thus, although the ownership is different before and after the QEI, "relatedness" can be tested at each step against the owners at that time. Our recommendation is simply to test "relatedness" after the QEI but before the QLICI, against the owners at that time.

We note that, due to the current priority scoring structure, for Applicants that fail to answer "yes" to Question 26, it is difficult to submit an application that is competitive. This has prevented many Applicants from using equity, which is the most flexible and non-traditional source of financing, as an investment tool.

Finally, we also believe that the amount of priority points given for the statutory preferences in IRC § 45D(f)(2) is too high compared with the total points for the Business Strategy section. We recommend that the points be lowered to 5 points total for Applicants that satisfy either statutory preference rather than 5 points each.

The third bullet point of Question 26(b) requires the Applicant to describe if it or any of its Affiliates will be lessees at projects financed in whole or in part by the QLICs. Often times, when CDEs invest in projects that combine the NMTC with federal historic tax credits, a lease pass-through structure is used that enables the QALICB to "pass through" the historic tax credits to its tenant rather than to its owners. This structure generally requires that the CDE own 100% of the "master tenant" entity, which leases all of the property from the QALICB. The CDE does not actually use the QALICB property, and instead, through the master tenant, leases all of the property to third party subtenants. Furthermore, the CDE does not manage the master tenant (rather the master tenant is typically managed by an affiliate of the project sponsor – typically the same entity that is the managing member of the QALICB). Furthermore, in some instances to facilitate the proper tax treatment for the federal historic credits, the master tenant entity becomes a member of the QALICB. The structure is in place solely to facilitate the pass through of all of the federal historic tax credits to the CDE's investor. We are concerned that reviewers may not understand a 3,000 character response on the pass-through lease structure that is used for NMTC transactions twinned with historic tax credits in which the CDE will be the 100% owner of the Master Tenant, a lessee of the QALICB and the Master Tenant may be a member of the QALICB. We recommend that the following question and answer be provided in the next update of the Application Q&A:

Question: If an Applicant intends to combine historic tax credits with NMTCs and use a pass-through lease structure in which the CDE will be the 100% owner of the Master Tenant, and therefore a lessee of the QALICB and/or a member of the QALICB, does the Applicant need to describe this relationship as a response to Question 26(b)?

Answer: No. Question 26(b) is not intended to capture information about relationships that require the Applicant, or its Affiliates, to be the lessee or member solely to enable the pass-through of federal historic tax credits through a master tenant.

- 4. The Application currently collects outcome information on the applicant's historic community impacts and projected economic development impacts in Table C1 and Table C2, respectively, and collects information on projected community development impacts in Question 30. Are there changes that should be made in the way projected economic development is currently measured? Are there other outcomes/impacts for which the Fund should be collecting information to ensure effective use of the NMTC? Should the Fund have a greater focus on community development outcomes/impacts? Alternatively, should the Fund focus exclusively on economic development outcomes/impacts?**

The Community Impact section and related exhibits require an Applicant to determine and use a methodology to quantify the community impact that its proposed activities will have. This information has been collected in nearly every application round. By requiring such information, the industry has developed methodologies to accurately collect the information to be reported to the CDFI Fund. The current data points are consistent with the data required for many popular economic development measurement tools, such as IMPLAN.

However, we recommend that the CDFI Fund go a step further and define data points for the applicant to collect related to community impact specifically. We recommend that Tables C1 and C2 be expanded to include some of the following community impact data on historic and projected financing:

- minority- women-owned businesses
- community facilities - including charter schools, health care facilities, libraries, and museums
- commercial real estate – including office, retail, and other types of space
- nonprofits – including those that offer social services, health care, wealth/asset building, and educational initiatives
- affordable housing – including first-time homebuyers and foreclosure prevention counseling

Regardless of whether new data points are added or not we believe the most important change the CDFI Fund can make in the collection of data is for the CDFI Fund to define standards for compiling the data that is acceptable and which provides the CDFI Fund the best information for determining its scores on the Community Impact section of the Application. These standards would help Applicants more properly calculate community impact and the CDFI Fund would receive applications with community impact calculations that were more comparable. Also, there is no guidance as to which data to collect when a NMTC loan finances a portion of a project or when multiple CDEs finance a project. There are so many different methodologies out there that it is hard to compare data between projects. By providing a standard methodology to collect data, there will be a clear understanding of the information that is needed and the expectations on the amount of community impact to be generated. A standard methodology would also help the CDFI Fund determine if the projects being funded with NMTCs are deriving the expected community impact described in the application. In the LIHTC industry, most state allocating agencies have guidelines for the market studies they require. These guidelines ensure that they have comparable data included in each market study. Otherwise, developers would submit studies prepared using various methodologies. We believe that similar guidelines could be given for the methodology to use to collect economic and community impact data.

5. Do Question 56 and Table F1 of the Application capture all sources of compensation and profits that the applicant and its affiliates receive in connection with NMTC transactions? How can collection of this information be improved? How should the Fund use this information? For example, should the Fund make the applicant's stated fees a specific condition of the Allocation Agreement, and should the Fund set limits on fees in the Allocation Agreement?

We recommend that stated fees not be a specific condition of the Allocation Agreement. We further recommend that Table F1 be removed because it does not provide enough flexibility for applicants to quantify their fees. We believe the goal should be to gain an understanding of the applicant's fee structure so the CDFI Fund can review it for reasonableness. One of the things that make the NMTC

industry so successful is the flexibility of the program to fund so many different types of projects. With this wide range of transactions come just as many structuring options to ensure as much benefit reaches the low-income community. In many NMTC transactions, the applicant and its affiliates are taking on significant risk, especially when you consider that the penalty for non-compliance is total recapture.

If the CDFI Fund chooses to set limits on the fees or make them a specific condition of the Allocation Agreement, we believe that it will discourage applicants from finding transactions that are more difficult to structure. It is often found that the most difficult transactions are not only the ones that don't have any other chance of penciling out without NMTCs but are also those that provide the most community impact. We believe that the generally consistent language in the allocation agreements is sufficient to ensure that applicants don't veer too far from the fees they described but allow for enough flexibility for an applicant to fund any transaction it may come across.

We also recommend that questions 55 and 56 be combined since most applicants are using fees to fund operations. We further recommend that an Applicant be allowed to provide a longer response of 5,000 or 10,000 characters to both (a) and (b) of question 56 due to the complexity and flexibility associated with the way fees are structured in NMTC transactions. With only 2,000 characters to fully describe the justification for a fee structure of an applicant, a reviewer may not be able to fully understand the reasoning and it could adversely affect the Applicant's score. This becomes increasingly difficult for Applicant's that have multiple product lines with different fee structures.

- 6. In any given Application round, the Fund requires applicants that have received awards in previous rounds to demonstrate that they have been able to raise minimum threshold amounts of QEIs from their prior awards (see the 2009 NOAA for the current minimum threshold requirements). Are these current minimum threshold requirements sufficient? Should the Fund consider using different measurements, such as the amount of QEIs that have been deployed as investments in low-income communities?**

We recommend that the CDFI Fund generally maintain its minimum threshold requirements of QEIs. We believe that the requirement to make QLICIs within 12 months of receiving QEIs is sufficient in ensuring that QLICIs will be made. We further recommend that CDEs be allowed to use QEIs that have been legally committed but not received to be included. For example, after a deal is closed and the funds are legally committed for venture capital and historic tax credit deals, equity is typically paid in over time, up to 18 - 24 months, based on a performance-driven pay-in schedule. Thus, a significant portion of the QEIs from its investors and QLICI pay-ins are not made until benchmarks are met. This deferred schedule allows the CDE to mitigate recapture risks and allows investors to mitigate construction and operational risks. Therefore, CDEs should be allowed to include the total dollar amount of closed deals whether or not the QEIs have been fully funded.

- 7. The Fund generally caps award amounts to any one organization in a given round. In the 2009 Application round, this cap was set at \$125 million. Is this an appropriate amount? Should the Fund consider raising the cap significantly (e.g., to \$250 million), and prohibit a CDE that receives such a large allocation award from applying again for an established period of time?**

We recommend that the CDFI Fund consider making multi-year awards. These awards would be limited to a significantly increased award cap (e.g. \$250 million). However, we recommend that multi-

year awards not be limited to large allocations. There are benefits to a multi-year award, regardless of its size. A large multi-year award to a large CDE would have the same benefits of a smaller multi-year award to a smaller CDE. For example, the CDFI Fund could allocate a \$250 million dollar, multi-year award to a CDE that has a strong track record in making NMTC investments at a large volume. We recommend that the allocation be made ratably from current and future rounds. We recommend that the CDE be prohibited from applying in any round in which its multi-year allocation is being awarded from. By granting CDEs multi-year awards, we believe it would allow those CDEs to manage their allocation better and choose projects that they may not choose because of the uncertainty of a future allocation.

8. In April 2009, the Government Accountability Office released a report titled: “New Markets Tax Credit: Minority Entities Are Less Successful in Obtaining Awards than Non-Minority Entities” (GAO-09-536). Are there actions that the Fund should take in order to increase the number of minority CDE applicants and allocatees?

We recommend that the CDFI Fund continue to reach out to educate, promote participation and determine ways to help minority entities increase their capacity to participate in the NMTC program. We applaud the CDFI Fund for its current efforts to do so and we believe that through greater outreach will come greater understanding of the program. We believe this kind of targeted outreach will increase the amount of minority entities that apply and ultimately will be more successful in receiving awards. In addition, we encourage the CDFI Fund to expand the current CDFI technical assistance program to include minority-owned or controlled CDEs. We recommend the CDFI Fund encourage current allocatees to mentor minority CDEs by making clear that a mentoring relationship will not create a common enterprise, as long as the mentoring relationship does not cede the minority CDE's actual decision-making to the mentor.

In addition to continual outreach, we recommend that the CDFI Fund modify the definition of a minority-owned or controlled CDE and make additional changes throughout the application to collect more information about an Applicant's intent to serve minority-owned or controlled CDEs. We recommend that the definition be modified to require:

- a. If a non-profit organization controls a CDE, a majority of the board of directors be a member of a minority population, or if a for-profit organization controls a CDE, a majority of the stock be held by individuals who are members of minority groups; and
- b. 50% or more of the applicant's and controlling entity's activities be targeted to low and moderate income minority populations and/or low income census tracts which are majority minority.

We further suggest eliminating the race/ethnicity of the Executive Director as a qualifying factor.

We recommend the CDFI Fund request additional information from the Applicant regarding minority-owned or controlled CDEs, as well as, incorporate additional references regarding minority-owned or controlled CDEs. To facilitate this requirement, we propose the following improvements to the allocation application:

- Question 14 requires the Applicant to indicate a percentage of each type of QLICI in which the Applicant intends to engage, of which there are five choices. We suggest adding an additional data point, 14(f), to this question to require the

applicant to identify the percentage of all of its activities identified in items 14(a) - 14(e) that the Applicant intends to invest in minority-owned or controlled CDEs. For the reasons we discussed earlier in our comment letter in regards to question 14, we do not believe that the percentage indicated for any bullet point should be a condition of their allocation agreement.

- Question 16 requires the Applicant to describe the flexible or non-traditional products, rates, or terms they intend to offer. We propose revising the language in 16(c) to "For an Applicant that indicated under Question 14c that it intends to finance other CDEs, **including minority-owned or controlled CDEs**, describe. . ." in order to ensure that information is collected on investments in minority-owned or controlled CDEs.
- For the same reasons for our recommended change to question 16 above, we recommend the language in question 18 be revised to "For an Applicant that indicated under Question #14d above that it plans to purchase qualifying loans from other CDEs, **including minority-owned or controlled CDEs**".
- Question 30 requires the Applicant to describe the impact of their QLICs. We recommend the addition of another subset to question 30(a) to include financing or assisting minority-owned or controlled CDEs.
- Lastly, we propose the addition of a column titled "Totals to Minority-owned or Controlled CDEs" to Tables A1, A2, and A3.

We caution the CDFI Fund from setting a minimum threshold similar to the non-metropolitan requirement that a certain amount of minority entities receive allocations unless it is statutorily asked to do so.

9. Are there changes that can be made to the application process or elsewhere, that will increase the amount of Qualified Low-Income Community Investments that support activities that have not traditionally received large scale financing from NMTC investment proceeds (e.g., loans and investments for small business operations; loans to and investments in other CDEs, including CDFIs; purchase of loans from other CDEs; etc.)?

We believe that the CDFI Fund should provide more information related to the scoring process and its preferences in the Application or NOAA. For example, if Applicants know that they will score an additional two points for committing 20% of their QEIs to be invested in small business operations, Applicants can make a more informed decision regarding commitments it makes in the Application. We believe that this quantitative information would allow Applicants to better understand the CDFI Fund's allocation priorities and respond appropriately. The CDFI Fund would be able to set clear policy objectives to steer allocations so that CDEs will increase the amount of QLICs that support activities that have not traditionally received large scale financing from NMTC investment proceeds. Although the CDFI Fund has provided TIPs in the Application they do not adequately explain the CDFI Fund's priorities. However, many applicants have tried to infer what the CDFI Fund's priorities are based upon the questions they ask or add in subsequent application rounds. For example, many CDEs have committed to providing at least 20% of the rental or for-sale housing units developed or rehabilitated as a

result of their investments as affordable housing units in response to question 30(c). We further believe that activities that have not traditionally received large scale financing from NMTC investment proceeds is due to statutory reasons. Due to the complexity of the regulations for the NMTC program, the rules favor certain types of investments from a risk perspective. We believe that risk is a major factor in any investor's decision. So the decision to invest more in other activities will not be accomplished until the perceived risk is reduced through statutory changes rather than creating priorities through the application process.

We also recommend a debriefing letter that includes the score received for each section and overall rankings be sent to each Applicant rather than only being sent to Applicants that don't receive an allocation. We believe that by revealing more details regarding the scoring process to Applicants the administration of the review process will remain manageable for the CDFI Fund while also providing more detailed information to the Applicants that will allow them to focus their overall business strategy and application content on the priorities of the CDFI Fund.

10. Currently, the Fund uses economic distress factors from the most recent decennial census to qualify eligible census tracts and to verify, when applicable, that awardees are serving "severely" distressed communities. Are there other public sources of data on economic indicators (e.g., American Community Survey three- and five-year estimates for poverty rate, area median income, and unemployment rate) that are updated more frequently and readily available that the Fund should accept?

We recommend that the CDFI Fund identify other public sources of data on economic indicators that are updated more frequently. The Federal Financial Institutions Examination Council's ("FFIEC") website offers a Geocoding System (<http://www.ffiec.gov/Geocode/default.aspx>) that is used for Community Reinvestment Act and/or Home Mortgage Disclosure Act data, and it includes demographic information based on the decennial census and the last three calendar years. Specific demographic information includes income, house, and population data. Because this data is updated annually, it provides a real-time assessment of the census tract and a more accurate reflection its demographics. By using more recently updated economic information, CDEs would be able to target areas that are either beginning to slide into a distressed state or are becoming even more highly distressed and invest in projects that may potentially stop the deterioration of a census tract. Also, it would detract from CDEs making investments in census tracts that were originally in a distressed market but have since recovered and are able to attract capital without NMTCs.

We recognize that this is one data source that is easily available but there may be many others. We recommend that the CDFI Fund only choose one data source if it does change which information to use. We would strongly caution against making multiple sources available. If the CDFI Fund chooses a data source that changes more often, such as annually, we recommend defining a point at which the applicant has to begin using the new data when it changes. Otherwise it will cause uncertainty during the underwriting process if it straddles two years of data. The CDFI Fund should set a certain period after which the data becomes available that it is effective for all transactions. By doing so, we believe it will reduce anxiety in the underwriting process and in making the determination of whether to start working on a transaction that may be located in a qualifying census tract today but could be unqualified before the underwriting is complete due to the availability of new data.

ADDITIONAL COMMENTS

Question 3

Question 3 of the Applicant Information section provides in the second TIP that:

“An Applicant may only designate an organization as a Controlling Entity that meets the definition of Controlling Entity set forth in the Notice of Allocation Availability (“NOAA”) and the Glossary of Terms and that currently controls the day-to-day management and operations (including investment decisions) of the Applicant.”

Question 31 of the 2007 NMTC Allocation Application Q&A Document (December 1, 2006) (the “Application Q&A”) states that the Controlling Entity must have, and is expected to maintain, the power to control the day-to-day management and operations (including investment decisions) of the Applicant and subsidiary entities such that it meets the definition pursuant to the NOAA, Glossary of Terms and related guidance [most notably the Allocation Agreement Q&A Document (January 2005)].

Question 25 of the Allocation Agreement Q&A Document (January 2005) (the “Allocation Agreement Q&A”) provides that control [of an Allocatee over a subsidiary allocatee] includes the power to exercise directly or indirectly a controlling influence over the management policies or investment decisions of another entity, as determined by the Fund. The guidance then continues to explain management control in Questions 26 and 27 and investment control in Question 28.

Question 50 of the Compliance and Monitoring Frequently Asked Questions Document (May 2009) (the “Compliance and Monitoring FAQ”) provides that control [of an Allocatee over a subsidiary allocatee] includes the power to exercise directly or indirectly a controlling influence over the management policies or investment decisions of another entity, as determined by the Fund.

We recommend that the NMTC Allocation Application provide for either management or investment control, not both, consistent with the Compliance and Monitoring FAQ and Allocation Agreement Q&A. In addition, the requirement that the Controlling Entity currently control the Applicant retroactively imposes a requirement on Applicants who received allocations in prior rounds where this requirement did not apply. We request that the requirement not be applied retroactively.

Question 12

We believe that the choices given for the Applicant to indicate its predominant real estate financing activity are limiting and don’t fit every business strategy. We recommend that the CDFI Fund add an activity listed as “Other” that the Applicant can clarify if it has an activity that doesn’t fall into one of the categories currently provided.

Question 19

We recommend that additional clarification be given to the information requested in 19(b) related to the applicant's delinquency/default rates. In many instances the CDE's peer group is other CDE's. Currently, we are not aware of any stated averages for the NMTC industry. We recommend the CDFI Fund provide clarification as to what stated industry averages a CDE could use.

Question 25

Question 25(a) requires the Applicant to indicate whether or not at least 50% of the Applicant's activities (financing or otherwise) over the past five years have been directed to Non-Metropolitan counties. Furthermore, if the Applicant indicates in Question 25(c) that it will commit to deploy a percentage of its QLICs in Non-Metropolitan counties, the Applicant, in Question 25(d), must describe its track record in providing or facilitating financing in Non-Metropolitan counties. In the 2009 Notice of Allocation Availability ("NOAA"), a Rural CDE is "one that has historically dedicated at least 50 percent of its activities to Non-Metropolitan counties **and** has committed that at least 50 percent of its NMTC activities will target Non-Metropolitan counties."

As the TIP and questions are currently worded, it is unclear if an Applicant can use the experience and track record of its Controlling Entity in answering Questions 25(a) and 25(d). If the Controlling Entity's experience and track record are excluded, the number of qualifying CDEs would be severely limited and possibly make it even more difficult for the CDFI Fund to meet its proportionality requirements. We recommend that the CDFI Fund add a "Question and Answer" to clarify that an Applicant may use the track record of its Controlling Entity when completing Question 25. We recommend that the following question and answer be provided in the next update of the Application Q&A:

Question: Can an Applicant use the track record of its Controlling Entity when responding to Questions 25(a) and (d)?

Answer: Yes. Just as the Applicant can designate that it is using its Controlling Entity's track record when completing the tables in Exhibit A, the Applicant may use its Controlling Entity's track record when responding to 25(a) and (d).

In order to further clarify the use of the track record of the Applicant's Controlling Entity, we recommend revising the wording in the next NOAA to be:

A Rural CDE is one that **itself or its Controlling Entity** has over the past five years dedicated at least 50 percent of its activities to Non-Metropolitan counties and has committed that at least 50 percent of its NMTC activities will be conducted in such areas.

Furthermore, we believe that there are Applicants with a track record of investing in rural areas (as defined in Section 520 of the Housing Act of 1949) that may not be located within non-metropolitan counties. We recommend that the CDFI Fund allow those Applicants to include their track record of activities in metropolitan rural areas when answering 25(a) and (d). We recommend that the following changes be made to 25(a) and (d) to allow for the inclusion of such a track record:

25. a. Have at least 50% of the *Applicant's* total activities (financing or otherwise) over the past five years been directed to *Non-metropolitan counties* **and/or rural areas (as defined in Section 520 of the Housing Act of 1949)**?

_____ yes _____ no

b. What is the minimum percentage of QLICs that the *Applicant* anticipates will be deployed in *Non-metropolitan counties* as part of its ordinary course of business?

_____ %

c. What is the maximum percentage of QLICs that the *Applicant* is willing to commit to deploy in *Non-metropolitan counties*? _____ %

d. If the response to Q.25 (c) above is greater than zero percent, briefly describe the *Applicant's* five-year track record of providing or facilitating QLICI and non-QLICI related activities (e.g., rental housing) in *Non-metropolitan counties and/or rural areas (as defined in Section 520 of the Housing Act of 1949)*. Be sure to indicate, both in real dollars and as a percentage of the *Applicant's* overall activities, the amount of loans, investments or related activities the *Applicant* has undertaken in *Non-metropolitan counties and/or rural areas (as defined in Section 520 of the Housing Act of 1949)*; referencing the tables in Exhibit A as appropriate. (Maximum Response Length: 3,000 characters)

In addition, we believe that it is important for an Applicant to understand prior to submitting an application what will be expected of commitments made in the Allocation Application if it receives an allocation. For this reason, we believe it would be helpful if there was clarification regarding reinvestment requirements for QLICs made in Non-Metropolitan counties that are used to satisfy the commitment made in Question 25. We believe that reinvestment requirements for QLICs made in Non-Metropolitan counties should be the same as those outlined in Question 29 of the Compliance and Monitoring Frequently Asked Questions document dated May 2009. We recommend that the following question and answer be provided in the next update of the Application Q&A:

Question: Will I be required to maintain the percentage of QLICs in Non-Metropolitan counties upon reinvestment?

Answer: (A) All allocatees must be able to demonstrate that they initially made QLICs in the amount specified in their allocation agreements which will be a percentage within the range given in response to Questions 25(b) and (c).

Example: If an allocatee received QEs totaling \$1 million, and is required in its allocation agreement to invest 20% of its QEs as QLICs in Non-Metropolitan counties, then it must be able to demonstrate that at least \$200,000 was initially invested as QLICs in Non-Metropolitan counties.

(B) If an allocatee subsequently receives repayments of principal from QLICs (e.g., amortizing loan payments), but consistent with applicable IRS regulations does not reinvest these proceeds into other QLICs, then the allocatee will be treated as fulfilling the requirements of its allocation agreement – notwithstanding the fact that the allocatee is no longer “fully invested” at the initial percentage.

Example: An allocatee received QEs totaling \$1 million, and is required in its allocation agreement to invest 20% of its QEs as QLICs in Non-Metropolitan counties. It makes a loan of \$200,000 to a QALICB in a Non-Metropolitan county and an \$800,000 loan to a QALICB in a Metropolitan county. In accordance with the terms of the loans, the QALICBs make interest-only payments for two years, and beginning in year 3, some small payments of principal along with the interest

payments. At the end of the seven-year compliance period, the principal payments from all QLICIs (including those made in Non-Metropolitan counties) total less than \$150,000 – or 15% of the \$1 million in loans to the QALICBs. This amount of repayment is sufficiently minimal as to not trigger reinvestment requirements under the IRS regulations. The allocatee is in compliance with its Non-Metropolitan QLICI commitment.

(C) If an allocatee subsequently receives repayments of principal from the QLICIs that are sufficient enough to trigger reinvestment requirements under the IRS regulations, the allocatee is required to reinvest those proceeds in the same percentage as is required in the allocation agreement so that it meets the Non-Metropolitan QLICI commitment.

Example: An allocatee received QEIs totaling \$1 million, and is required in its allocation agreement to invest 20% of its QEIs as QLICIs in Non-Metropolitan counties. It makes a loan of \$200,000 to a QALICB in a Non-Metropolitan county and an \$800,000 loan to a QALICB in a Metropolitan county. The Non-Metropolitan QALICB repays the entirety of the loan after two years. The allocatee must reinvest the entire \$200,000 into Non-Metropolitan QLICIs within the timeframes required under IRS regulations in order to be compliant with the allocatee's Non-Metropolitan commitment.

Table A1

We request further clarification on the data that can be included in Table A1. An Applicant may elect to use the track record of its Controlling Entity. However, it is unclear if the track record of the Applicant can be included in the Controlling Entity's track record when the Applicant is a subsidiary of the Controlling Entity. We recommend that the track record of both entities be allowed to be inputted into Table A1. To facilitate the collection and distinction of this information, we recommend the table be expanded and include new lines 5-8 requesting the same information as lines 1-4 but for the Controlling Entity. The combined track record would then be summed together at the bottom. Allowing the Applicant to provide information about both entities will allow reviewers to distinguish the activities of the Applicant, which tend to be NMTC related and the Controlling entity which may not be NMTC related.

In the changes to Q&A #29 dated February 5, 2008 and continued in Q&A #30 dated January 12, 2009, the CDFI Fund made certain changes to clarify the data to be provided in Exhibit A. In so doing, certain wording changes were made from the previous Q&A document that appear to require a different analysis than previously required. In particular, the CDFI Fund has deleted a sentence that provided: "You do not need to demonstrate that the activities quantified in these annual columns were provided to businesses **that also meet the criteria of a QALICB.**" (emphasis added). Please clarify that an Applicant does not need to verify that previous real estate businesses financed were actually QALICBs; this would be an exceedingly difficult task for any Applicant who is including QLICI-like (but not QLICI) activities as the Applicant would have to verify whether the business held too much nonqualified financial property, who its subtenants were, etc. Similarly, in the following paragraph, the sentence that previously stated "When completing a given table, Applicants should report on the totality of historical activities requested in the table – not just the portion of those activities **that meet the definition of a**

QLICI.” (emphasis added). This has been changed to provide: “When completing a given table, Applicants should report on the totality of historical activities that could potentially qualify as NMTC investments requested in the table – not just the portion of those activities that were undertaken in NMTC-eligible low-income communities.” Again, the rewording of this Answer suggests that an Applicant has to verify that the QLICI requirements are met.

Common Enterprise

Based on (i) the CDFI Fund’s broad definitions of “Affiliate¹” and “Control²”, (ii) the provision in the NOAA and Application Q&A that states that an Applicant that receives an allocation in the current round is prohibited from becoming an Affiliate or member of a common enterprise with another Applicant that receives an allocation in this round at any time after the submission of the allocation application, and (iii) the fact that the allocation application provides that “The term “Applicant” refers to the CDE applying for a NMTC Allocation as well as any other Subsidiary entities, whether already formed or in the process of formation, which may receive a transfer of all or a part of a NMTC Allocation from the Applicant,” we believe that many entities applying in the next allocation application round may inappropriately be considered Affiliates of, or members of a common enterprise with, other Applicants and therefore would not be eligible to apply.

There is an exception in the NOAA and in Application Q&A question 16, which states:

This prohibition, however, will not apply when an investor: (i) makes QEIs in multiple Allocatees (or Subsidiary Allocatees) from the same allocation round; (ii) was not an Affiliate of any of the Allocatees (or Subsidiary Allocatees) prior to making the QEIs; and (iii) obtains Control of such Allocatees or (Subsidiary Allocatees) solely through common ownership and/or control of their investment decisions after the QEI is made.

Our concerns regarding this language and its effect on Applicants are as follows:

1. If an investor and an allocatee each plan to apply in the next application round, and the investor has previously invested in the allocatee (or any of its subsidiary entities), then the exception will not apply. The exception does not apply because the investor doesn’t meet the requirement of clause (ii), because the investor would be deemed an Affiliate (by virtue of either its ownership or control rights in connection with its prior investment) before making

¹ The Glossary of Terms of the 2008 New Markets Tax Credit Allocation Application provides that an Affiliate is defined as:

Any legal entity that *Controls*, is *Controlled* by, or is under common *Control* with, the *Applicant*.

² The Glossary of Terms of the 2008 New Markets Tax Credit Allocation Application provides that Control is defined as:

- (1) Ownership, control, or power to vote more than 50 percent of the outstanding shares of any class of voting securities of any entity, directly or indirectly or acting through one or more other persons;
- (2) Control in any manner over the election of a majority of the directors, trustees, or general partners (or individuals exercising similar functions) of any other entity; or
- (3) Power to exercise, directly or indirectly, a controlling influence over the management policies or investment decisions of another entity, as determined by the Fund.

the QEI. As such, their applications will be in jeopardy of being thrown out by the CDFI Fund because they will technically be Affiliates and/or members of a common enterprise.

2. If an investor gives one or more commitment letters to other Applicant(s), and if the investor is also an Applicant in the same round, the investor may be subject to disqualification due to investor committing to becoming an Affiliate of, or part of a common enterprise with, the other Applicant(s) when the investments are made.
3. If an investor gives commitment letters to more than one Applicant (irrespective of whether the investor is also an allocatee), and that investor has invested in either of those Applicants or their subsidiaries in the past, all Applicants with a commitment letter from the investor may be subject to disqualification, due to the investor being an Affiliate based on one or more prior QEIs and committing to becoming an Affiliate and/or a member of a common enterprise when they invest.

We suggest changing the wording of the applicable paragraphs in the NOAA and in Application Q&A question 16 to the following:

This prohibition, however, will not apply when an investor: (i) makes QEIs in **one or more** Allocatees (or Subsidiary Allocatees) from the same allocation round **or any prior rounds**; (ii) was not an Affiliate of, **or a member of a common enterprise with**, any of the Allocatees (or Subsidiary Allocatees) prior to making the QEIs **except if said status arises solely from making or having made QEIs on the terms as described in clause (iii) hereof**; and (iii) **has and/or** obtains Control of such Allocatees or (Subsidiary Allocatees) solely through common ownership and/or control of their **management and/or investment decisions related to QEIs described in clause (i) hereof**.

Absent these changes, the above limitations will likely severely impede (i) the ability of many qualified Applicants who have also made investments or plan to make investments in other allocatees to apply in future application rounds and (ii) the ability of many other Applicants to obtain investor commitments for their applications.

Submitting attachments and signature pages

We request that the CDFI Fund send the Applicant an email confirming receipt of the attachments and signature pages it has submitted. We further recommend that if attachments and signature pages are not received by the deadline that the Applicant is granted a 3 day cure period. The Applicant then must send the required documents postmarked no later than the end of the cure period. This would allow the Applicant a reasonable method to resolve any issues with the delivery of the attachments and signature pages since they cannot be uploaded with the Application.

Mr. Matt Josephs
Community Development Financial Institutions Fund
October 12, 2009

Conclusion:

We are excited about the positive impact that the New Markets Tax Credit Program is having on the nation's low-income communities and low-income persons. We appreciate the opportunity to submit our comments on the 2009 NMTC Allocation Application. Thank you in advance for your time and consideration. Please do not hesitate to contact us if you have any questions regarding our comments or if we can be of further assistance.

Yours very truly,
Novogradac and Company LLP



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